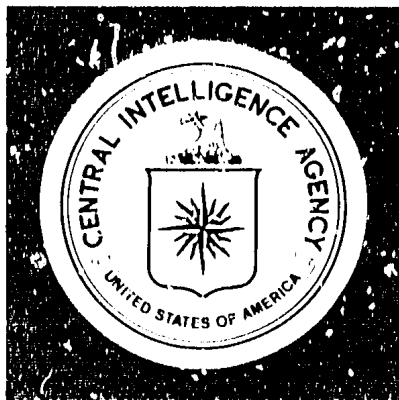


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27 August 1975

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ECONOMIC INTELLIGENCE WEEKLY

27 August 1975

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Overview

The Outlook for Record 1975/76 World Grain Supplies Has Dimmed Considerably Since June. Dry growing conditions in the USSR, northern Europe, the United States, and Canada have cut 40 million tons from earlier forecasts of 1 billion tons. Instead of a 7% increase over last year, only 2.8% is now expected. This reduction prevents any rebuilding of world grain stocks, estimated at a record low of about 100 million tons on 30 June 1975.

World wheat supplies will be tighter than those for feedgrain. Wheat production, forecast at 350 million tons, is no larger than a year ago, with most of the shortfall occurring in the USSR and Europe. Massive Soviet and East European import requirements will boost global demand for US wheat to a new high of about 36 million tons. Exports of this magnitude could occur without lowering US stocks. World prices will remain strong because of low world grain stocks and uncertainty about additional Soviet purchases.

We Now Estimate the Soviet Grain Crop at 170 Million Tons, roughly 50 million tons short of requirements. So far this year the USSR has bought 15.3 million tons of grain; confirmation of rumored purchases would add another million tons to the total. Although further purchases are expected, the Soviets will have to make other adjustments to cope with the shortfall. Most likely they will draw down stocks, reduce feed rations and herds, and import meat or soybeans as grain substitutes. In addition, they will reduce their grain shipments to client states. Moscow has apparently asked East European customers to look to the West for all of this year's grain imports.

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The Volume of Trade in the Seven Major Developed Countries Continued To Fall Sharply in the Second Quarter, although more slowly than in early 1975. We estimate that the decline in import volume slackened to an annual rate of 10%, from 30% in the first quarter. Export volume fell 9% after declining by 14% in the previous three months. Declining demand outside the Big Seven apparently was a strong factor in the second quarter export slide.

Trade volume in second half 1975 will stagnate, at best. Big Seven imports seem likely to increase slightly as these countries begin to recover from their worst postwar recession. With recovery lagging in the smaller OECD countries and with non-oil LDCs facing payments problems, Big Seven exports to outside countries probably will decline further. The volume of exports to OPEC and Communist countries will continue to grow, though at a slower pace.

As a result of these volume trends and less favorable terms of trade, the \$17.4 billion surplus recorded by the Big Seven in January-June will fall substantially in the second half 1975 -- perhaps by 50%. The expected deterioration in the trade account is serving as a constraint on reflation efforts. Japan and France in particular are eager to maintain a favorable trade position; Italy and Britain can ill afford a renewed round of large deficits.

Monetary Reform Discussions at Next Week's IMF-IBRD Meetings will focus on quota revisions and the role of gold. The major European countries support a plan to increase quotas about one-third by doubling the OPEC quota and by reducing shares of the developed countries. They also agree in principle that central banks transact gold among themselves at market prices with a provision to prevent the buildup of central bank gold holdings. Under the European plan, the IMF would reduce its gold holdings by one-third. Half of it would be sold to support low interest loans to LDCs and the remainder returned to members at the official price. (Confidential No Foreign Dissem)

Articles

SOVIET GRAIN: RECENT DEVELOPMENTS

Our end of August estimate of the Soviet grain crop is 170 million tons, up slightly from the previous forecast of 165 million tons.

Production and Requirements

The revision reflects more the receipt of new information than an improvement in Soviet grain crop conditions. Recent rains came too late to give much relief to grains, even though they improved the outlook for potatoes and sugar beets. Because this year has been marked by the worst drought in the past two decades, an estimate of the crop is subject to an unusual margin of uncertainty. Furthermore, in times of agricultural difficulties, the Kremlin is even more secretive about releasing information on crop conditions and yields, even at the local level; indeed, the Soviet leadership has kept this year's large grain imports a secret at home.

The shortfall in Soviet production in relation to requirements will be roughly 50 million tons, much more than the world market can provide. Since mid-July the USSR has purchased 15.3 million tons of grain, including 9.8 million tons from the United States. Rumored purchases would boost the total by more than a million tons. Moscow continues to search for available grain, having commissioned one US-based grain company to snap up any non-US origin wheat, corn, and barley.

East European Situation

In addition, the USSR will limit its grain shipments to client states. Eastern Europe's grain import requirements in FY 1976 are now placed at about 9 million tons, close to the average for past years. Moscow usually supplies about one-half of these requirements; this year, most or all of the Soviet share probably will be filled by the United States. [REDACTED] Moscow has recently asked East European governments to look to the West for all of this year's grain imports, with financing to be provided by the USSR. Moreover, Yugoslavia reportedly is in the market for 1 million tons of wheat, which may be destined for the USSR; both our estimates and Belgrade's own statements show no domestic need for such a purchase.

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Port Capacity

Soviet grain imports are not constrained by port capacity. Assuming reasonable scheduling, ports in the USSR can handle up to 36 million tons of grain imports a year. Total deliveries in 1973 reached 24 million tons, two-thirds of present port capabilities, with no major delays reported. The domestic transport system can manage grain shipments of 36 million tons at the cost of diversion of freight cars from other uses and consequent short-term economic disruptions.

Soviet Options

Even though the Soviets are continuing to buy grain, they will have to make substantial domestic adjustments to cope with a large part of the shortfall. Moscow will draw on its small cushion of State grain reserves (estimated roughly at 10 million tons) and will take some combination of the following steps:

- reduce the quality of bread (as Khrushchev did following the poor 1963 harvest), with a saving of approximately 4 million tons of grain;
- cut livestock inventories (a 5% reduction would lower the demand for feedgrains by about 6 million tons);
- reduce feed rations per head of livestock while maintaining the current livestock inventory, saving up to 13 million tons;
- increase meat imports, thus reducing domestic demand for livestock feed by possibly another 4 million tons; and
- import soybeans to stretch feedgrain supplies. (Secret No Foreign Dissem

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DEVELOPED COUNTRIES: CAUTIOUS POLICY RESPONSE TO UNEMPLOYMENT

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[REDACTED] Most governments continue to grope for an economic strategy that will be effective in combatting the recession while not jeopardizing gains made in controlling inflation and reducing payments deficits.

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By any measure, the global slump has taken a painful toll in jobs.

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Italian figures, which show only a small rise in unemployment, mask a substantial amount of hidden unemployment in the form of short-time work. With all signs pointing toward a tardy and slow recovery, the developed countries, particularly the European countries, face the prospect of rising unemployment at least through the end of 1975.

Cautious Reflation

Of the six major foreign countries, only Italy has thrown caution to the wind and embarked on a vigorous program of domestic reflation. Despite rapid inflation and balance-of-payments problems, Rome has announced a \$5.5 billion (3% of GNP) program of fiscal expansion; it has been encouraging an expansionary monetary policy since early in the year.

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France have vocally supported the need for reflation; the measures they plan for later in the year nonetheless are mild.

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The planned French program of \$3.5 billion amounts to less than 1% of GNP, a small stimulus for an economy that is expected to dip 2% this year, compared with a traditional growth rate of more than 5%.

The Inflation Constraint

The unbridled inflation of recent years has left a legacy of caution among most policymakers, a legacy that continues to moderate all steps toward reflation.

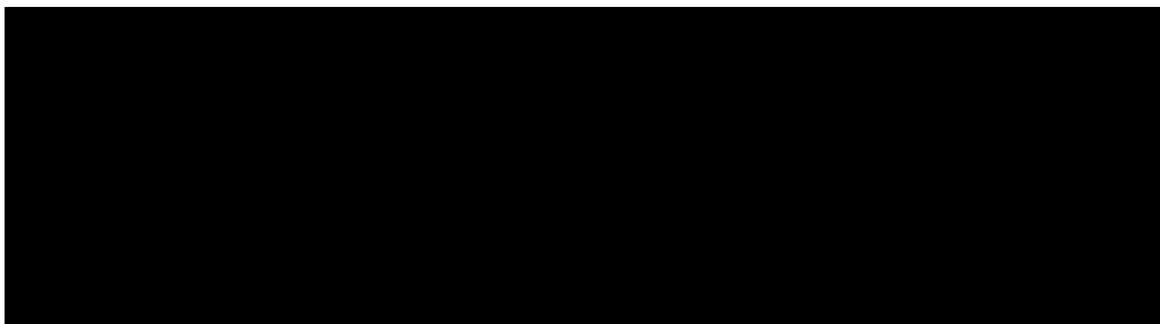
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The Italian leadership, in contrast, appears willing to run considerable inflation risks in an effort to spur recovery. Its new program of fiscal expansion comes at a time when inflation, though down considerably from last year, remains high by international standards.

The Payments Constraint

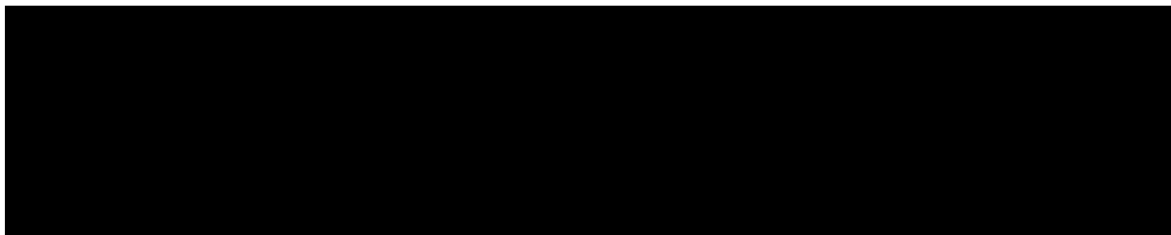
The foreign sector is an equally important constraint on policy actions to spur recovery. Although Italy, Britain, France, and Japan have all made remarkable progress in improving their payments balances, these gains are considered the transitory product of steep recession. Each worries that more rapid expansion at home than abroad will make imports swell faster than exports, leading to a renewal of unmanageable payments deficits.

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Paris [redacted] appear to place the highest priority on maintaining a strong payments position. [redacted] reluctance to push ahead faster than the United States, its major trading partner, is moderating the pace of reflation. Because French orthodoxy abhors a payments deficit, Paris is structuring its expansionary policy to minimize the threat to the recently strengthened current account.

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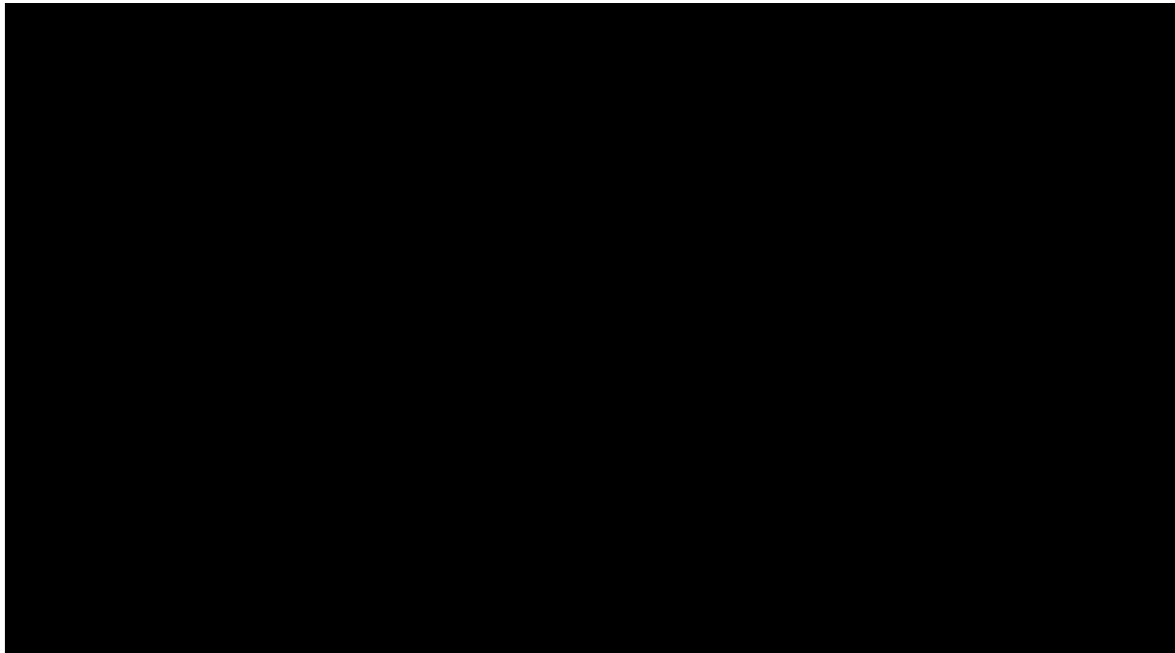


Until recently, the major European countries have been content to sit tight, awaiting a pickup in world demand. With few signs of an upturn on the horizon, the wait for export-led growth has become ever more frustrating. France and Germany now are finding mounting support for their view that the stronger economies must adopt a policy of coordinated reflation.

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FRANCE

Until recently, Paris single-mindedly followed a policy of cutting inflation and curbing payments deficits. Last year, the government curtailed the growth of bank credit, worsening the contraction in spending. Although interest rates have eased since the first of the year because of a drop in demand for credit, monetary policy has continued to be restrictive. At the same time, fiscal policy has done little to offset the decline in French consumer purchases. This policy of rigid restraint has met its objectives with notable success, at the cost of a sharp jump in unemployment. With close to 1 million Frenchmen out of work, President Giscard now is worried about the political backlash from unemployment.

Although Paris does not intend to relent in the fight against inflation and continues to place great weight on maintaining a trade surplus, starting next January it plans to spend \$3.5 billion on pump priming measures to add jobs. In September, Giscard will introduce a budget for the coming fiscal year that deliberately provides for a deficit, a rare move for any French government. Giscard hopes that public pronouncements will spur private spending and is launching his initiatives with considerable fanfare. France would prefer to see a coordinated recovery among all the developed countries because it fears that isolated expansion would lead to a return of payments deficits.

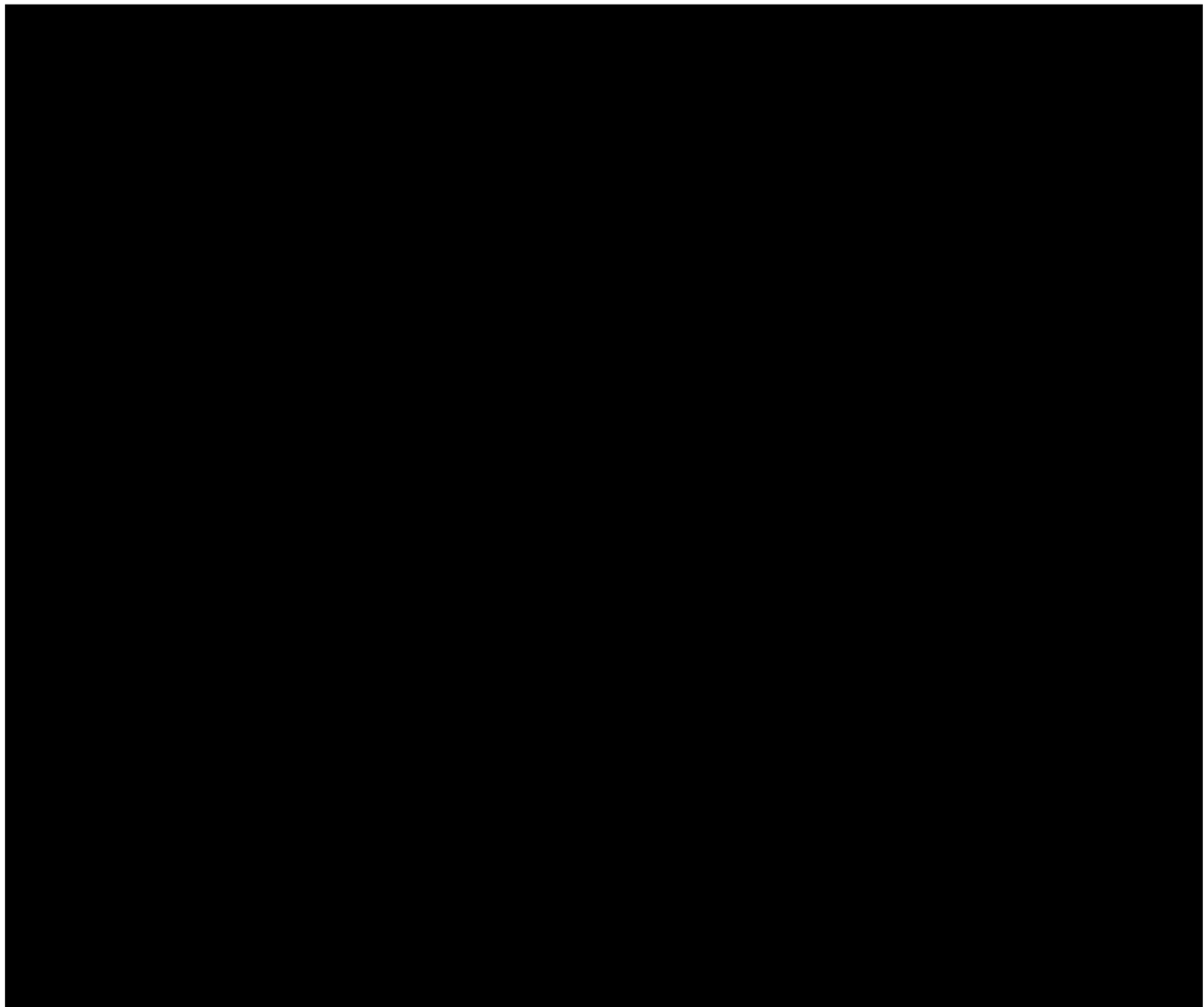
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ITALY

Political pressures have forced a sharp reversal of economic policy in Italy in the last month. With the Communists making strong inroads at the ballot box, the center-left government of Prime Minister Moro has felt compelled to adopt a policy of vigorous fiscal expansion to prop up the sagging economy. The new policy jeopardizes hard-won gains in the fight against inflation and balance-of-payments deficits.

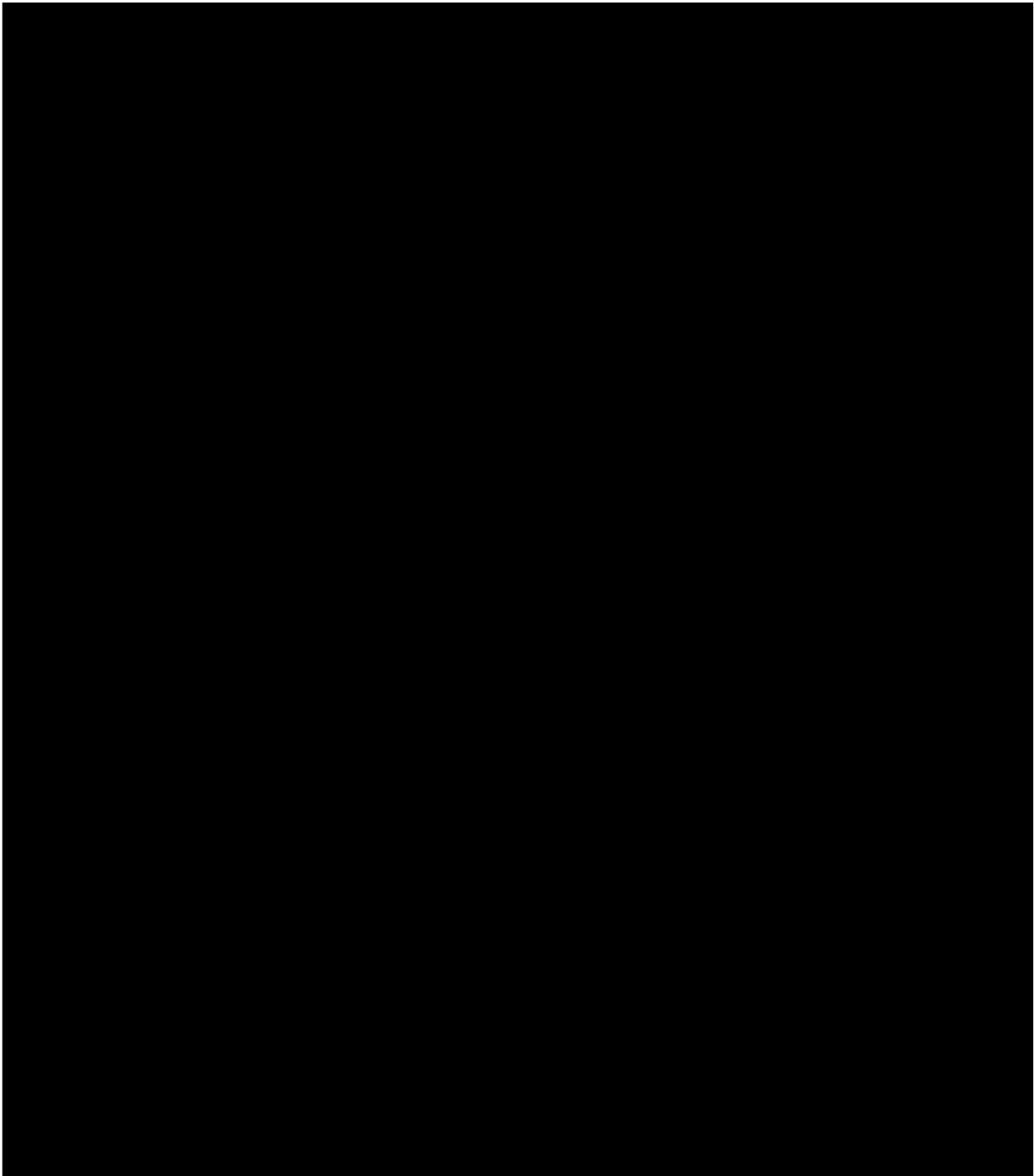
Rome's new fiscal package will add \$5.5 billion to the spending stream by speeding up the expenditure of funds on previously proposed projects. It will help boost the government's budget deficit (on an appropriations basis) to 9%-10% of GNP next year. Most of the spending will be on public investment and regional development and on the underwriting of exports. Monetary policy had already turned expansionary earlier in the year, following several months of stability in the money supply.

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FRANCE: TRADE SURPLUS TEMPORARY

The French trade account, which showed a surprising \$1.5 billion surplus in the first half of 1975, probably will be back in the red within six months or so.*

* F.o.b.-f.o.b. The later discussion of commodity and geographic trends is based on f.o.b.-c.i.f. data because an f.o.b.-f.o.b. breakdown is not available.

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Because of the great importance Paris traditionally attaches to maintaining a trade surplus, expectations of worsening trade accounts, reinforced by Giscard's fear of inflation, will inhibit the government in carrying out expansionary measures. This set of priorities is reflected in the relatively small measures that have been taken or are in planning to cope with the recession.

Commodity Trade Patterns

An extraordinary rise in net exports of manufactured goods underlies the recent improvement in the trade account. On an f.o.b.-c.i.f. basis, this surplus totaled an estimated \$2.5 billion in second quarter 1975, compared with \$0.5 billion in last quarter 1973—a rise that more than offset the jump in the cost of energy imports over the same interval. The improvement largely arises from striking differences in the performance of export and import volume over the last year or so. In first quarter 1975, the import volume of manufactures was down 15% over the same period in 1974. Export volume, on the other hand, was up slightly, reflecting a strong short-term competitive position, aggressive export promotion by senior government officials, and the filling of backlogged prerecession orders. The strengthening of the competitive position was the result of comparatively low valuation of the franc throughout 1974.

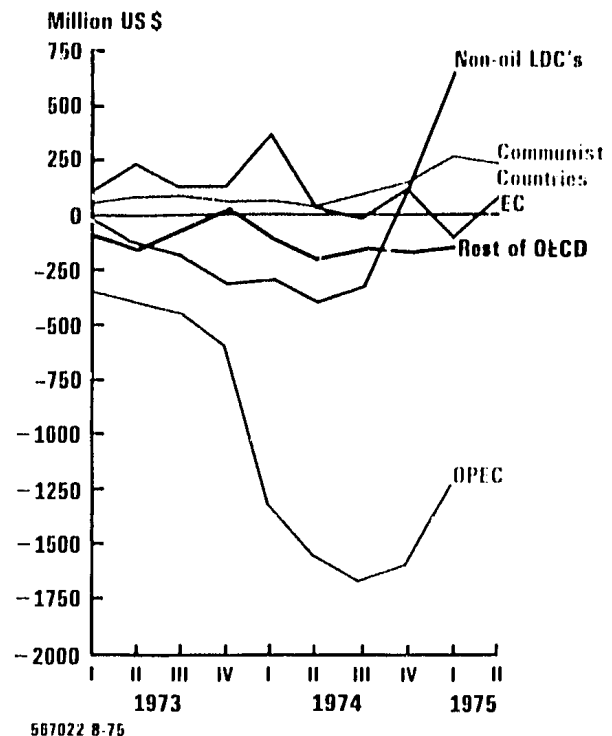
Net energy imports peaked in the third quarter of 1974 and declined thereafter as oil imports slumped in response to mild weather, stock drawdowns, and the industrial recession. By first half 1975, the volume of oil imports was 21% below first half 1973. The deficit in raw materials trade has followed a similar pattern; the falloff in net imports since third quarter 1974 reflects both declining volume and lower world prices. The surplus on foodstuffs declined fairly steadily since early last year before recovering somewhat in the second quarter of 1975.

Geographic Trade Patterns

France experienced a spectacular worsening in its OPEC trade balance in most of 1974, followed by an impressive turnaround in late 1974. The rebound reflects,

FRANCE: Trade Balance, by Area

(f.o.b.-c.i.f., seasonally adjusted)



**France: Trade Balance, by Category, f.o.b.-c.i.f.
(Seasonally Adjusted)**

	Million US \$			
	Raw Materials	Energy	Foodstuffs	Manufactures
1973				
I	-372	-766	380	548
II	-461	-886	467	581
III	-528	-1,046	601	597
IV	-509	-838	507	512
1974				
I	-561	-1,982	871	228
II	-698	-2,556	698	488
III	-783	-3,183	687	1,158
IV	-614	-2,935	570	1,782
1975				
I	-632	-2,859	407	2,631
II ¹	-536	-2,621	597	2,489

1. Estimated.

about equally, reduced imports of oil and increased exports of manufactures, especially capital goods. France, among the developed countries, has done quite well in OPEC markets, with Algeria accounting for nearly half of its OPEC sales. The trade balance with the non-oil LDCs has improved even more than with OPEC, apparently for similar reasons: smaller imports of raw materials and stepped-up exports of manufactures.

As for trade with the EC, France has managed to turn a \$400 million quarterly deficit into a \$100 million surplus, comparing second quarter results. A plunge in French purchases of German capital goods and autos has been a key factor; exports to Germany have been holding up well. The trade deficit with other OECD countries has narrowed slightly over the same period. Rising exports meanwhile have substantially boosted the trade surplus with the Communist countries.

Outlook

The French trade position (f.o.b.-f.o.b.) is likely to deteriorate considerably in second half 1975 and slip back into deficit early next year. The size of the deficit in 1976, however, should be well below the 1974 average of \$850 million per quarter—perhaps on the order of \$200-\$400 million quarterly.

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The recovery in oil imports is expected by itself to wipe out much of the trade surplus. As output begins to recover, oil demand should return to roughly the 1973 level, adding more than \$500 million quarterly to the import bill. An OPEC price hike of \$1.50 per barrel would raise this figure to \$800 million.

Net imports of raw materials are also likely to jump by yearend, possibly by \$200 million per quarter as businessmen begin to restock for the industrial recovery. Prices of raw materials also should firm up as the industrial world pulls out of recession.

The present huge surplus in trade in manufactures is almost certain to shrink. Recent sharp appreciation of the franc, combined with above-average domestic inflation, already has damaged the competitiveness of French goods. A recent survey confirms that even after shaving export prices an average of 4% below domestic prices, French businessmen are experiencing a substantial price handicap in foreign markets.

French exports appear more sensitive to domestic economic conditions than to foreign developments. French businessmen appear to favor the home market, pushing exports less hard when domestic demand is high. Thus, even if economic recovery in France only keeps pace with the rest of the world, the French trade balance could suffer. (Confidential) ■

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LDC PAYMENT POSITION DETERIORATES

The payments position of the non-oil LDCs deteriorated rapidly in first half 1975. Changes in bank borrowing, aid flows, and reserve levels indicate that the LDC current account deficit increased by \$4-\$6 billion in January-June. We estimate that the deficit in last half 1974 was about \$16 billion. Because the current level of LDC borrowing is unsustainable, a cutback in LDC imports is already under way. Thus the deficit in the second half, while still formidable, will decline. Some debt rescheduling is inevitable, and exchange holdings will continue to dwindle.

Preliminary statistics indicate that the LDC trade deficit with the major developed countries increased \$2.7 billion in first half 1975. Direct information on the 1975 trade and services balances of the LDCs with the rest of the world is not available. We arrived at our estimate of the current account trend by examining the flow of financial resources to the LDCs in the first half of 1975.

Non-Oil LDCs: Selected Financial Flows and Reserves

	Billion US \$		
	2d Half 1974	1st Half 1975	Change
Net bank borrowing in the United States and the United Kingdom	4.4	9.0	4.6
Aid flows (concessionary loans)	6.8	9.0	2.2
IMF net credits	1.1	0.6	-0.5
Reserve drawdowns	1.4	0.5	-0.9

These changes indicate a current account balance deterioration of roughly \$5 billion. Information on direct investment and bank flows from other areas is not available; we believe changes in these flows will not be large enough to alter our estimate by more than \$1 billion in either direction.

Bank Borrowing

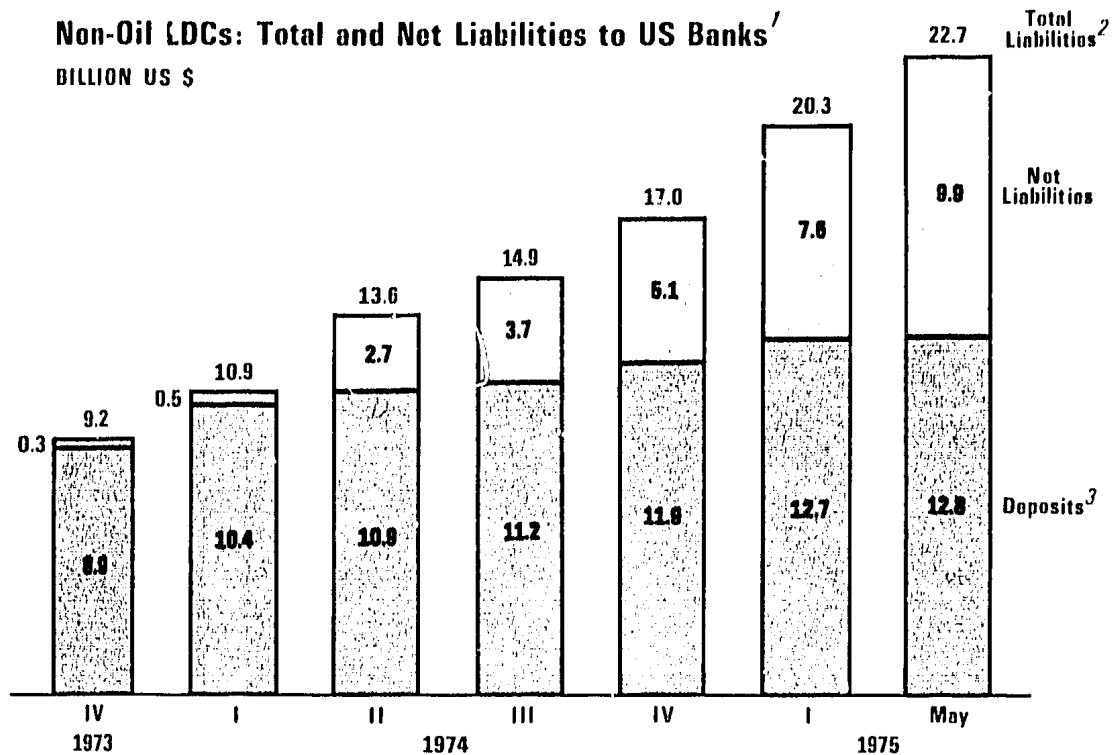
We estimate, based on data through May, that LDC borrowing from US commercial banks amounted to a net \$5.5 billion in first half of 1975. Among the larger LDCs, South Korea and Mexico borrowed nearly \$500 million each and Chile about \$100 million. Incomplete data for 1975 on LDC borrowing from commercial banks in London, the other major market, show a surge of new credits, perhaps amounting to \$3.5 billion net.

Aid

Owing to increases in concessionary lending, total aid flows to the LDCs rose by roughly \$2 billion in first half 1975. OPEC flows accounted for most of the increase, growing from \$3 billion for the whole of 1974 to an estimated \$3.5 billion in January-June 1975. Moslem countries received about 70% of the OPEC total. We estimate aid from the remainder of the world, mainly from OECD countries, at \$5.5 billion, compared with roughly \$5 billion in second half 1974.

The IMF

The rate of IMF lending declined from last year's record pace. LDC net drawings from the IMF were \$570 million in first half 1975, compared with \$1.1 billion in second half 1974. The new oil facility accounted for 80% of the 1975 total.



¹Excluding balances of areas engaged in "offshore" banking. Data are as of the end of the period.

²Total liabilities includes all short and long-term obligations of non-oil LDCs to US banks. Loans to public institutions and private banks and businesses, letters of credit, and bankers' acceptances account for most of such LDC obligations.

³Deposits include all short and long-term claims of public and private entities in non-oil LDCs on US banks. Time and demand deposits and US government securities in custody of US banks account for most of such claims.

Reserve Position

Despite the increased aid and borrowing, LDC reserves fell from \$30.1 billion at the end of 1974 to \$29.6 billion by May 1975.

Prospects

Aid flows are unlikely to increase substantially in second half 1975. Any increases will probably be concentrated in those Moslem countries that received the bulk of OPEC aid in the first half. We expect LDC exports earnings to pick up moderately as raw material prices start to recover. A substantial increase in volume, however, will lag the economic upturn in the developed countries by several months.

LDCs are under pressure to reduce the size of their current deficits during the remainder of the year, if only because they cannot continue to borrow at the same rate from US and UK banks. Most of the cut in the deficit will have to be accomplished by reducing imports. LDC governments have already taken steps to cut back foreign purchases. (Confidential)■

Note

GM Negotiates Van Contract with Poland

Negotiations between General Motors and Poland on joint production of light service vans probably will result in the largest contract ever between a US firm and Poland. The proposed \$300 million contract, expected to be concluded by yearend, calls for GM to provide engineering design for multipurpose vans and production technology for a new plant to produce 100,000 vans a year. GM will buy back some of the output for sale in Western markets, and Poland will export many of the vans to CEMA countries. (Confidential)

Publications of Interest*

Syria: The State of the Economy

(ER IM 75-15, August 1975, Secret No Foreign Dissem)

This memorandum on the Syrian economy highlights the factors that are expected to sustain the solid economic growth achieved since 1969. It describes the domestic development efforts, which are being supported by unprecedented aid from Arab countries.

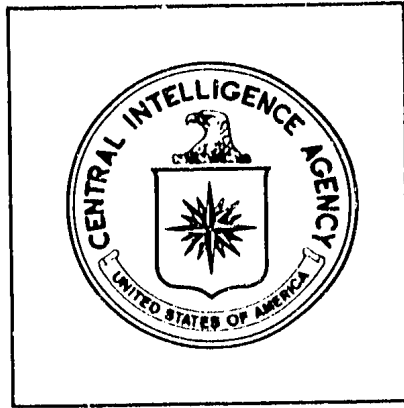
People's Republic of China: Handbook of Economic Indicators

(ER A(ER) 75-72, August 1975, Unclassified)

This handbook brings together economic estimates for the People's Republic of China, a country that has not released economic statistics systematically since 1960.

* Copies of these publications may be ordered by calling [REDACTED] Code 143, Extension 7234.

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ECONOMIC INDICATORS

Prepared by

The Office of Economic Research

August 27, 1975

Foreword

The *Economic Indicators* provide up-to-date information on changes in the domestic and external economic activities of the major non-Communist developed countries. To the extent possible, the *Economic Indicators* are updated from press ticker and Embassy reporting, so that the results are made available to the reader weeks - or sometimes months - before receipt of official statistical publications.

Comments and queries regarding the *Economic Indicators* are welcomed. They may be directed to [REDACTED] the Office of Economic Research, Code 143, Extension 7402 or 351-7402.

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